Agricultural Law Press

Publisher/Editor
Robert P. Achenbach, Jr.

* * * *

Issue Contents

Agricultural Law Digest

Volume 29, No. 16 August 24, 2018 ISSN 1051-2780

Qualified Business Income - New Proposed Regulations, Part I

by Robert P. Achenbach, Jr.*

The Tax Cuts and Jobs Act of 2017 (TCJA 2017) repealed the domestic production activities deduction[1] and replaced it with the qualified business income deduction (QBID).[2] The QBID, in general, provides for a deduction of up to 20 percent of qualified business income (QBI), subject to several limitations.[3]

In general, QBI refers to the net amount of qualified items of income, gain, loss and deduction on each qualified trade or business carried on in the US by a taxpayer.[4] Qualified items do not include:

(1) short-term capital gains or losses or long-term capital gains or losses;
(2) dividends, income equivalent to a dividend or payment in lieu of a dividend;
(3) interest income, except for interest income allocable to a trade or business;
(4) certain commodity gain or loss or foreign currency gain or loss;[5]
(5) income, gain, loss or deduction of notional contracts;[6]
(6) annuity income not from a trade or business; and
(7) items of deduction or loss allocable to amounts in items (1) through (6).[7]

QBI also does not include wages or compensation, guaranteed payments made to partners for services to the partnership, and payments for services to a partnership made by a partner but not in the partner's capacity as a partner.[8]

For qualified trades or businesses with income above $157,500 (single taxpayers) and $315,000 (joint filers),[9] the deduction has three limits:

(1) the maximum of 20 percent of taxable income, excluding net capital gains;
(2) 50 percent of wages[10] reportable on Form W-2 allocable to the qualified trade or business (up to the limitation in (1)); and
(3) 25 percent of wages reportable on Form W-2 in the qualified trade or business plus 2.5 percent of the unadjusted basis,[11] upon acquisition, of all qualified property (up to the limitation in (1)).[12]

Qualified property is defined as tangible depreciable property under IRC § 167 held at the end of the tax year and used for the production of income in the trade or business.[13] The property must have not been completely depreciated by the end of the tax year.

Qualified Trade or Business

A qualified trade or business is any trade or business other than a specified service trade or business or a trade or business of an employee.[14]

The TCJA 2017 did not define the terms "trade or business" but the proposed regulations

---

* Publisher and editor of the Agricultural Law Press.

Agricultural Law Digest is published by the Agricultural Law Press, 735 N. Maple Hill Rd., Kelso, WA 98626 (ph 360-200-5666), bimonthly except June and December. Annual subscription $90 by e-mail. http://www.agrilawpress.com Printed on recycled paper.

state that the term trade or business is that used by IRC § 162 and the numerous cases under that statute ruling as to whether a taxpayer had trade or business income.[15] Under the proposed regulations, the term "trade or business" is defined as

> ". . . a section 162 trade or business other than the trade or business of performing services as an employee. In addition, rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business which is commonly controlled under §1.199A-4(b)(1)(i) (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under § 1.199A-4(b)(1))."

Thus, the mere rental of farm property without regular and continuous participation in the activity by the landlord or an agent does not rise to the level of a trade or business and the rent income is not included in QBI.[16] However, that extreme case rarely occurs and most rental of farmland is a trade or business eligible for deductions for related expenses under Section 162. Where farm rental activity does not rise to the level of a trade or business, farm rental income is reported on Form 4835, *Farm Rental Income and Expenses,* and Schedule E, but is not included in SE income on Schedule SE.

The proposed regulations extend the definition of trade or business beyond Section 162 in one circumstance. Solely for purposes of the QBI, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the other trade or business is commonly controlled.[17]

Specified Service Trade or Business

The QBID for a specified service trade or business with income below the income limits is 20 percent of QBI.[18] Thus, a farm or ranch business which qualifies as a trade or business with taxable income, excluding net capital gains, of less that $157,500 (single filer) or $315,000 (joint filers) is eligible for the 20 percent QBID.[19] The deduction is reported on Form 1040 as against adjusted gross income, independent of itemized deductions and alternative minimum tax. Note that the income limitations apply to adjusted gross income; thus, other business deductions may reduce income from a trade or business below the income limitations for QBID.

The definition of a specified service trade or business applies only if the taxpayer's taxable income from a trade or business, as defined under I.R.C. § 162, exceeds $157,500 for single taxpayers ($315,000 for married taxpayers).[20] For incomes above those limits, the QBID is phased-out when the income reaches the above limits plus $50,000 ($100,000 for joint filers).[21] Within the phase-in range, for any tax year, the limit is phased in by a percentage equal to the ratio of (1) the taxable income of the taxpayer for the tax year greater than the threshold amount over (2) $50,000 ($100,000 for joint filers).

Example: Married taxpayers have specified trade or business income of $340,000. They are eligible for a QBID of 10 percent. ($340,000-$315,000 = $25,000; $25,000/$50,000 = 0.50; 20 percent QBID x 0.50 = 10 percent QBID).

For income above those limits, a specified service trade or business is any trade or business identified in IRC § 1202(e)(3)(A) other than engineering and architecture, or which would be so described if the term employees or owners was substituted for employees.[22] A specified service trade or business also means the performance of services that consist of investing and investment management, trading, or dealing in securities,[23] partnership interests, or commodities.[24] A specified service trade or business also includes businesses providing services in the areas of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.[25]

Qualified Business Loss

If a qualified trade or business (or specified service trade or business) would normally qualify for a QBID but instead has a qualified business loss, the loss is carried over to subsequent years and reduces the QBID for that subsequent tax year by 20 percent of the carryover loss.[26] Thus, if a trade or business has a $20,000 in unused QBI in 2018 carried over to 2019 when the business has a QBI deduction (excluding the carryover loss) of $50,000, the 2019 QBI deduction is $46,000 (0.20 x $20,000 = $4000; $50,000 - $4,000 = $46,000 QBID for 2019).

ENDNOTES

[1] Pub. L. No. 115-97, § 13305, 131 Stat. 2126 (2017). See Harl, Farm Income Tax Manual, § 3.27 (2018) for discussion of DPAD. The IRS has issued proposed regulations for the QBID. Notice 2018-64, I.R.B. 2018-35, ___.

[2] Pub. L. No. 115-97, § 11011, 131 Stat. 2063 (2017), adding I.R.C. § 199A. Proposed regulations were issued in early August 2018. 83 Fed. Reg. ____ (2018).

[3] Pub. L. No. 115-97, § 11011, 131 Stat. 2063 (2017), adding I.R.C. § 199A(a).

[4] Pub. L. No. 115-97, § 11011, 131 Stat. 2065 (2017), adding I.R.C. § 199A(c).

[5] See I.R.C. § 954(c)(1)(C) and (D).

[6] See I.R.C. § 954(c)(1)(F).

[7] Pub. L. No. 115-97, § 11011, 131 Stat. 2065 (2017), adding I.R.C. § 199A(c).

[8] Pub. L. No. 115-97, § 11011, 131 Stat. 2065 (2017), adding I.R.C. § 199A(c).

[9] Pub. L. No. 115-97, § 11011, 131 Stat. 2623 (2017), adding I.R.C. § 199A(b); Prop. Treas. Reg. § 1.199A-1(d). These limits are indexed for inflation.

[10] Pub. L. No. 115-97, § 11011, 131 Stat. 2064 (2017), adding I.R.C. § 199A(b)(4).This includes the total wages subject to withholding, elective deferrals, and deferred compensation. See Prop. Treas. Reg. § 1.199A-2. See also Notice 2018-64, I.R.B. 2018-34 (methods for calculating W-2 wages - see summary below).

[11] Note that this is acquisition basis without reduction for any depreciation. See Prop. Treas. Reg. § 1.199A-3(a)(3).

[12] Pub. L. No. 115-97, § 11011, 131 Stat. 2063 (2017), adding I.R.C. § 199A(b). See Prop. Treas. Reg. § 1.199A-2.

[13] Prop. Treas. Reg. § 1.199A-2(c).

[14] Pub L No 115-97, § 11011, 131 Stat 2066 (2017), adding IRC § 199A(d).

[15] Prop. Treas. Reg. § 1.199A-1(b)(13).

[16] Note that, if the landlord's participation rises to the level of "material participation," the rent in most cases is not only trade and business income but self-employment income, reported on Schedule SE. See Harl, *Farm Income Tax Manual*, § 8.05[3] (2018) for discussion of leasing of farm property as a trade or business for self-employment purposes.

[17] Prop. Treas. Reg. § 1.199A-1(b)(13); Prop. Treas. Reg. § 1.199A-4(b)(1)(i).

[18] Pub. L. No. 115-97, § 11011, 131 Stat. 2066 (2017), adding I.R.C. § 199A(d).

[19] Pub. L. No. 115-97, § 11011, 131 Stat. 2066 (2017), adding I.R.C. § 199A(d). These limits are indexed for inflation.

[20] Prop. Treas. Reg. § 1.199A-1(b)(8). These amounts are indexed for inflation.

[21] Pub. L. No. 115-97, § 11011, 131 Stat. 2067 (2017), adding I.R.C. § 199A(e); Prop. Treas. Reg. § 1.199A-1(b)(8).

[22] Pub. L. No. 115-97, § 11011, 131 Stat. 2066 (2017), adding I.R.C. § 199A(d). Prop. Treas. Reg. § 1.199A-5(b).

[23] As defined in I.R.C. § 475(c)(2).

[24] As defined in I.R.C. § 475(e)(2).

[25] Prop. Treas. Reg. § 1.199A-5(b). A similar list of service trades or businesses is provided in I.R.C. § 448(d)(2)(A) and Treas. Reg. § 1.448-1T(e)(4)(i).

[26] Pub. L. No. 115-97, § 11011, 131 Stat. 2065 (2017), adding I.R.C. § 199A(c).

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

FEDERAL TAX

DISCHARGE. The debtors originally filed a Chapter 11 case in January 2012 but the case was dismissed in June 2013. The debtors then filed a Chapter 7 no-asset case in September 2013 in which the IRS did not file a claim, although the IRS received notice of the Chapter 7 filing. The debtors received a discharge in the Chapter 7 case in December 2013. The debtors owed taxes for 2008 and 2009 and argued that these taxes were discharged in the Chapter 7 case because the IRS did not file a claim, resulting in the loss of priority for the tax claims. The court held that the failure to file a claim in a no-asset Chapter 7 case did not necessarily result in a loss of priority of the claim; in fact, the court noted that the notice of the Chapter 7 case to creditors stated that a proof of claim was not required. Under Section 523(a), an individual debtor shall not be discharged from any tax debt specified in Section 507(a)(8) which defines such tax debts as follows:

". . . allowed unsecured claims of governmental units, only to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition—

(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; . . .."

The dispute in this case was whether the income tax obligations here fall within the time frame established under subsection (i) of §507(a)(8)(A). The court found that the 2009 tax return was due on October 15, 2010 because the debtors received the automatic six-month extension. Thus, the court held that the three years had not elapsed when the debtors filed their Chapter 7 case in September 2013. The 2008 return was due, because of the automatic extension, on October 15, 2009. The IRS argued that the prior Chapter 13 case tolled the three year limitation period for the 2008 taxes during the pendency of that case from January 2012 until June 2013, thus extending the three year period to April 2014. The IRS cited *Young v. United States, 535 U.S. 43 (2002)* which held that a bankruptcy case tolls the limitation period. However, the court noted that Congress had amended Section 507 in 2005 after the *Young* case to add a tolling provision for Section 507(a)(8)(a)(ii) but not for Section 507(a)(8)(a)(i); therefore, the court interpreted the change to indicate that Congress did not want any tolling to occur for Section 507(a)(8)(a)(i) claims. Therefore, the court held that the Chapter 11 case did not toll the limitation period for the 2008 taxes and they were discharged in the Chapter 7 case. **Comment by editor**: It appears that the court failed to account for the other 2005 amendment of Section 507(a)(8). At the end of Section 507(a)(8) is an un-numbered paragraph: "An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; *plus any time during which the stay of proceedings was in effect in a prior case under this title* or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days."(Emphasis added). This clearly codifies the *Young* holding. In addition, the argument that Congress, by adding a tolling provision in one section, indicated that no other tolling should occur, is less than convincing. As the court here indicated, without the tolling provision, debtors could file specious bankruptcy cases to delay IRS collection long enough to eliminate the priority of tax claims. **Clothier v. I.R.S., 2018-2 U.S. Tax Cas. (CCH) ¶ 50,373 (W.D. Tenn. 2018)**.

FEDERAL ESTATE AND GIFT TAXATION

DISCLAIMERS. The decedent had been the beneficiary of a pre-1977 trust which provided that during the decedent's lifetime,